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Executive Secretary
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THE WHITE HOUSE
WASHINGTON

July 18, 1985

NOTE FOR WILLIAM J. CASEY

FROM: ROGER B. PORTER RBP

The revised agenda and papers for the July 19 Meeting of the Economic Policy Council are attached.

Executive Registry
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19 Jul 85
Section 301
Multi-Fiber
Agri Credit Policy
Revised

THE WHITE HOUSE

WASHINGTON

July 18, 1985

MEMORANDUM FOR THE ECONOMIC POLICY COUNCIL

FROM: ROGER B. PORTER RBP

SUBJECT: Revised Agenda and Papers for the July 19 Meeting

A revised agenda and papers for the July 19 meeting of the Economic Policy Council are attached. The meeting is scheduled for 3:00 p.m. in the Roosevelt Room.

Yesterday afternoon's Economic Policy Council meeting focused exclusively on economic conditions in the farm sector and alternative legislative approaches. We did not have time to discuss agricultural credit policy. Because of the time sensitive nature of the agricultural credit policy issue we will need to take it up on Friday. This will necessitate deferring consideration of the Common Fund to a future meeting. The revised agenda is as follows:

The first agenda item concerns implementation of the Section 301 citrus decision. A brief paper from Ambassador Yeutter on the U.S.-E.C. Citrus/Pasta Disputes is attached.

The second agenda item concerns the Multifiber Arrangement (MFA) negotiations. The Council will review the issue of U.S. support for extension, modification, or expiration of the MFA. A paper, prepared by the chairman of the EPC Working Group on the Multifiber Arrangement, reviewing this issue was distributed to Council members yesterday. Another copy is attached.

The third agenda item concerns agricultural credit policy. The Working Group on Agricultural Credit Policy has prepared a paper on the role of the Federal Government in addressing the credit difficulties faced by many U.S. farmers and in facilitating adjustment to a more stable farm credit situation. A copy of this paper, which was distributed to Council members on July 15, is also attached.

Attachments

DCI EXEC REG

THE WHITE HOUSE

WASHINGTON

ECONOMIC POLICY COUNCIL

July 19, 1985

3:00 p.m.

Roosevelt Room

AGENDA

1. Implementation of the President's Section 301 Citrus Decision

2. Multifiber Arrangement Negotiations

3. Agricultural Credit Policy

THE UNITED STATES TRADE REPRESENTATIVE

WASHINGTON, D.C. 20506

July 17, 1985

MEMORANDUM

TO: Roger Porter

FROM: Ambassador Yeutter

SUBJECT: U.S.-EC Citrus/Pasta Disputes

Per your request, attached is an update of the pasta-citrus situation for discussion at the EPC meeting on Friday.

2. Not implemented / [illegible]
3. [illegible] not [illegible] - give up - get 90 days to negotiate

U.S. EC CITRUS/PASTA DISPUTES - AN UPDATE

Issue

As a result of the President's June 20 decision to take action against EC pasta imports in retaliation for the EC's discriminatory tariff treatment on U.S. citrus exports, the U.S. and EC are expected to work out an agreement by Friday, July 19 which may ultimately resolve both citrus and pasta disputes. The proposed U.S.-EC agreement, as it has taken shape over the last week, is as follows:

- With respect to pasta:

  - The EC will reduce its subsidy on exports to the U.S. by 6 ECU's per 100 kg of pasta (approximately $.02 at current exchange rates which represents a 45% reduction from the July subsidy) and will explain the details of its calculation;

  - The U.S. will refrain from further action in the Subsidies Code on pasta on the understanding that this is without prejudice to our legal interpretation of Art. 9 of the Subsidies Code (which prohibits such export subsidies) and that the U.S. has reserved its right to re-open this case if the subsidy substantially increases;

- With respect to citrus:

  - The U.S. and EC agree to suspend their respective actions on pasta, and walnuts and lemons until October 31; in the interim we will hold consultations on citrus. Our expectation is that before October 31 the EC will have taken steps to provide a meaningful increase in market access for U.S. citrus;

  - If citrus is satisfactorily resolved, the pasta (and the EC's lemon and walnut) duty increase would be terminated.

Background

On June 20 the President exercised his authority under Sec. 301 of the Trade Act of 1974 to increase duties on pasta imports from the EC as a response to the EC's discriminatory tariff treatment of U.S. citrus exports. The higher pasta duties were to take effect on July 6. On June 27 the EC announced that it would retaliate against the U.S. by increasing duties on lemon and walnut imports from the U.S. However, on July 5, EC officials informed the USTR that the EC was prepared to reduce both the subsidy on pasta exports to the U.S. and the MFN rate of duty on citrus imports as a means of resolving these disputes. The EC needed more time to provide details on the pasta subsidy reduction. Therefore, USTR, after consulting with Customs, agreed to give the EC a grace period to develop its pasta proposal. The proposal as it was eventually worked out is described above.

OFFICE OF THE UNITED STATES
TRADE REPRESENTATIVE
EXECUTIVE OFFICE OF THE PRESIDENT
WASHINGTON
20506

July 11, 1985

MEMORANDUM

TO: Roger B. Porter
Executive Secretary, Economic Policy Council

FROM: Ambassador Richard H. Imus

SUBJECT: Economic Policy Council Working Group on the Multifiber Arrangement

In response to your memorandum of July 5, I am attaching the options paper you requested. The paper was discussed with members of the Working Group on the MFA and all support Option C. Ambassador Yeutter has also read and cleared this paper.

Attachment

OPTIONS PAPER FOR MEMBERS OF THE ECONOMIC POLICY COUNCIL

FROM: AMBASSADOR RICHARD H. IMUS, CHAIRMAN
ECONOMIC POLICY GROUP ON THE MULTIFIBER ARRANGEMENT

Issue For Decision

Should the U.S. support extension, modification or expiration of the Multifiber Arrangement at the July 23, 1985 meeting of the GATT Textiles Committee.

I. Background

The Issue

The current Multifiber Agreement (MFA III) expires on July 31, 1986. The MFA provides that one year prior to the expiration participants shall meet to decide whether the MFA should be "extended, modified, or discontinued." A meeting of the GATT Textile Committee has therefore been called for July 23, 1985. It is important to note that this meeting is not for the purpose of negotiating a new MFA but to determine, whether the MFA should be allowed to expire next year or whether negotiations for extension or modification should begin. In the latter case, negotiations will begin this fall.

Country Attitudes

a) Exporters. Officially, the developing countries (textile apparel exporters) have called for termination of the MFA and return of textile and apparel trade to the general procedures of the GATT. Privately, some LDC exporters have told us that they would favor continuation of the MFA, providing it did not overly restrict their export opportunities. In short, the exporters are divided.

b) European Community. Slow economic growth and weak currencies have held down European imports during this MFA. The Community seems satisfied that the present MFA and its bilateral agreements are sufficient. Therefore, the EC basically favors an extension of the present arrangement probably with liberalization. Imports are again growing in Europe, however, and in time we may see the EEC more concerned about this issue than they are now.

Except France

[illegible]

c) Canada. The Canadians have experienced the same import surges as we. They, therefore, will press for a tighter MFA to give them more authority to take more restrictive action in the future.

d) Japan. Japan is a member of the MFA but imposes no formal import restraints. Problems are growing, however, with imports from China, Korea, and Pakistan. Japan will probably follow our lead but will not be of much real support in the negotiating process.

II. Options

(A) Allow the MFA to expire and return textiles to the normal GATT system.

Pros

1) Would please the LDCs and contribute to a more favorable atmosphere for the new round negotiations.

2) Would be a strong statement by the Administration for more open trade.

Cons

1) The Administration would take enormous criticism domestically.

2) We would give impetus to the textile/apparel quota bill.

3) To continue any level of protection for the domestic industry we would have to use normal procedures of GATT Article 19. This is a more complex and difficult process.

(B) Extend the present MFA — use as chip in New Round

Pros

1) This would be the easiest course to accomplish. It would put us and the EC together. Most LDC's, while unhappy with the present MFA, could live with it.

2) The trade knows this system and can live with it.

3) The present MFA is vague enough to allow us to negotiate quite stringent agreements should we decide upon that course.

Cons

1) Domestic industry feels the present MFA offers inadequate protection. They would strongly oppose a simple extension.

2) The present system has been a constant source of bilateral conflict. This would continue.

— dlffn—
— Pacific
— Potted pockets
impacts

(C) Modify the MFA (with no strategy or goal.)

Pros Political reality

1) We may be able by careful balancing to deal with the concerns of our own industry and some of those of the LDCs.

2) The present MFA and its predecessor agreements have continued essentially unchanged for over 20 years. The terms and conditions of the MFA thus reflect the patterns of world trade of the past not the present.

3) Would provide strong leverage in the Administration's opposition to protectionist legislative proposals.

4) Would provide an opportunity to close some of the loopholes of the present Arrangement.

Cons

1) Everyone wants their own changes to the MFA. Once we start the process of revision the negotiations will be long and arduous. There is a real possibility no agreement will be reached.

2) Revision could well mean a more protectionist position for the U.S. than present MFA (though less protectionist than present legislative proposals). We could, therefore jeopardize the New Round and other trade liberalizing efforts.

Recommendation

The EPC Working Group unanimously agrees that Option C is the course for the U.S. to pursue. While we need some additional time to develop specific recommendations for the actual negotiations in the fall, we should go on record in Geneva on July 23

--- calling for a new MFA to replace the existing accord

--- stating the problems our industry has faced under the present Arrangement.

--- calling upon our trading partners to cooperate in solving these problems.

--- assuring exporting nations that we will be willing to negotiate issues with which they are concerned.

Given the urgency of this issue we will work toward convening formal negotiations this fall. We will also try to convince our trading partners that it is in everyone's interest to handle the negotiations expeditiously.

Following the July 23 meeting, the EPC Working Group will complete its present analysis of basic facts and develop policy options for presentation to the EPC shortly after Labor Day.

THE WHITE HOUSE

WASHINGTON

July 15, 1985

MEMORANDUM FOR THE ECONOMIC POLICY COUNCIL

FROM: THE WORKING GROUP ON AGRICULTURAL CREDIT POLICY

SUBJECT: Agricultural Credit Policy: Farmers Home Administration

Issue: What role should the Federal Government play in addressing the credit difficulties faced by many U.S. farmers and in facilitating adjustment to a more stable farm credit situation? If Federal intervention is needed, in what form should it be provided?

This memorandum reviews the origins of the agricultural credit problem, the sources of agricultural credit, and the actions taken by the Administration thus far to address the agricultural credit problem. It focuses on the specific issue of how the Federal Government should address its increasing direct exposure to the agricultural credit problem through the Farmers Home Administration. A second memorandum will address the issue of how the Federal Government should address the problems of the Farm Credit System.

Origins of the Agricultural Credit Problem

The farm sector is now undergoing a necessary correction to the extraordinary agricultural boom of the mid- and late-1970's. In the 1970's, overall demand for U.S. farm products grew rapidly, with export markets expanding dramatically. Increased demand, rising productivity, and declining labor inputs caused real income from assets to rise sharply. In response to these incentives, augmented by government farm support programs, the tax code, and negative real interest rates, capital investment in agriculture increased and land values were bid up. Debt rose about as fast as the increase in assets. An increasing share of debt was provided by the Federal Government and the Farm Credit System (FCS), which played a major role in financing land speculation.

In the 1980's, the annual growth of demand slowed to only 1 percent for some commodities and actually declined for others. The appreciation of the dollar and the slowdown in economic growth abroad slashed exports. The relative decline in demand, combined with several bumper crop years, undermined farm prices. High interest rates over the last six years also reduced income. The less profitable outlook for farming, high real interest rates, and reduced inflationary expectations, pulled down farm land prices and assets while debt rose, squeezing farm equity.

Field crop and livestock operators in the Corn Belt, Lake States, and Southern Plains are facing the greatest financial difficulties. As of January 1985, 9.9 percent of all farmers had debt-to-asset ratios over 40 percent and negative cash flow; these farmers owed 45.3 percent of all farm debt.

Sources of Agricultural Credit

The distribution of agricultural debt at the end of 1984 was as follows.

	$ Billions	% of Total	%Change from 1983
Farm Credit System	67.9	31.9	-1.6
Commercial Banks	49.9	23.4	3.2
Individuals and others	48.1	22.6	-6.2
Farmers Home Administration	25.7	12.1	7.0
Life Insurance Companies	12.4	5.8	-2.1
Commodity Credit Corporation	8.9	4.2	-17.7
Total	212.9	100.0	-1.5

Farmers Home Administration (FmHA). The financial problems of the farm sector are adversely affecting the FmHA. From October 1 through June 19 of FY 1985, FmHA provided about $4.6 billion in direct and guaranteed loans to farmers -- a 92 percent increase over the same period in FY 1984. Direct loans made up 82 percent of the total credit provided. Most of the lending is to new borrowers. About 30 percent of all FmHA loans, or $8.5 billion, is delinquent. The higher lending in 1985 has increased the loss exposure on these loans.

The dramatic increase in FmHA exposure is due to its position as a "lender of last resort." The FCS and commercial banks are turning away many borrowers and directing them to the FmHA for their operating loans. Although these operating loans are not provided for real estate purposes, they enable the borrower to service his or her existing real estate debt. These loans have become de facto entitlements, which the FmHA virtually cannot foreclose.

Given current policy, the existence of the FmHA inhibits the restructuring of the farm sector, which further depresses land values and forces more borrowers out of the FCS and banks and into the FmHA.

A brief description of agricultural lending by the other two major lending groups experiencing difficulty -- commercial banks and the FCS -- is attached.

Actions Taken

In response to rising concerns about the deteriorating conditions in farm finances and the adequacy of operating credit, the Administration initiated in September 1984 a series of actions to provide adequate crop loans for 1985. These initiatives, along with greater credit from commercial banks and private individuals, resulted in all but about 5 percent of farmers obtaining operating credit for the current year -- instead of the 15 percent or higher shortfall predicted at the beginning of the lending season.

In February 1985, the Administration made a commitment to increase significantly short-term FmHA direct lending. The agency currently projects $4.25 billion will be lent directly by the end of FY 1985, compared with the $2.57 billion planned in the budget. The guaranteed lending program, after a slow start-up, should commit $1.1 billion by the end of FY 1985, compared with the $700 million planned in the budget.

The Agricultural Credit Problem

The fundamental problems now faced by farmers, and therefore by lenders to farmers, derive in large part from the farm subsidy system that has existed for the last 50 years, in which the government, rather than market forces, basically determine income. This has resulted in a severe demand-supply imbalance, which is the basic root of the problems faced by farmers, including agricultural credit. Consequently, a fundamental reform of farm policy directed at a market-oriented program is necessary to address the basic problems faced by farmers, as well as the agricultural credit problem.

The core of the agricultural credit problem is that there are substantial amounts of loan losses that will eventually have to be realized. The basic issue is who will absorb the losses -- private lenders or taxpayers through the Federal Government.

The Administration has several objectives in addressing the agricultural credit problem:

- It should establish a framework in which the flow of credit into the agricultural sector eventually conforms more closely with the market allocation of credit.

- It should minimize the short- and long-term budget costs of any solution.

- It should ensure that any credit solution is consistent with our overall agricultural policy.

Without policy changes, the agricultural credit problem will deteriorate rapidly in the next several months. The deteriorating credit conditions will adversely affect the FmHA particularly as more borrowers are forced to turn to it for credit. The potentially large demand for FmHA credit would undermine the Administration's efforts to reduce Federal spending.

Farmers Home Administration Options

Option 1: Limit FmHA direct lending to servicing its existing portfolio. Eliminate FmHA real estate lending. Authorize FmHA to guarantee new operating loans up to a maximum of 70 percent under existing qualification rules.

Advantages

- o Closing the FmHA direct credit window and ending real estate loans minimizes Federal budget outlays which have grown at unprecedented rates.
- o Having the commercial market bear a significant portion of the risk on guaranteed loans helps insure the viability of these loans.
- o This reorientation of FmHA would promote the transition of unproductive resources out of agriculture and close down the de facto entitlement for all farmers rejected elsewhere in the credit system.

Disadvantages

- o Since this option would curtail loan activity more marginal farmers would have to liquidate their assets, hastening an already rapid decline in asset values.
- o Agricultural interests would strongly oppose this reorientation since it would effectively limit the flow of credit, particularly for real estate lending. Currently roughly 12 percent of FmHA loans are for real estate.
- o Farm income would decline further in the short run.

Option 2: Limit FmHA direct lending to servicing its existing portfolio. Limit FmHA real estate lending to no more than current levels. Continue FmHA guaranteed loans under existing authorities (maximum of 90 percent guarantee) under existing qualification rules.

<u>Advantages</u>

- o Closing the direct credit window at FmHA eases the short-run pressure on budget outlays.
- o Eases the adjustment for farmers by promoting a slower transfer of unproductive resources out of agriculture.
- o This approach could be implemented through regulations and would not require congressional acquiescence.

<u>Disadvantages</u>

- o Absorbing most of the risk on guaranteed loans promotes lower quality loans by commercial lenders, significantly increasing the ultimate Federal budget exposure.
- o Continuing FmHA activity in a deteriorating land market enhances the possibility of long-term budget outlays for defaulted real estate loans.
- o Some agricultural committee members may feel that the Administration has exceeded its regulatory discretion and move to block these changes through legislation.

<u>Option 3</u>: <u>Limit FmHA direct lending to servicing its existing portfolio. Eliminate FmHA real estate lending. Authorize FmHA to guarantee new operating loans up to a maximum of 70 percent under existing qualification rules.</u>

<u>Consider creating a Federally-chartered, privately-owned credit institution (Aggie Mae) to purchase nonperforming farm real estate and equipment loans from any recognized financial institution.</u>

Financial institutions (Farm Credit System, commercial banks, etc.) holding nonperforming real estate or equipment loans would obtain voluntary or forced liquidations. After foreclosure, the collateral would be sold on a discounted basis to Aggie Mae, which would be authorized to hold and manage the real estate or equipment for a period of from five to ten years.

The corporation would be authorized to lease the land or equipment to any qualified operator, including the current one, if qualified. It would use the proceeds to pay interest and principal on its securities. Aggie Mae, at its discretion, could dispose of land or equipment with the lessee retaining the right of first refusal at the time the holding was offered for sale. The potential cost to the Federal Government would be limited to the proportion of the Aggie Mae securities it guarantees, depending on economic conditions five to ten years out.

Advantages

- Agreeing to the creation of Aggie Mae could help achieve the needed reorientation of FmHA.
- Closing the FmHA direct credit window and ending real estate loans would reduce near-term budget outlays.
- By allowing the Farm Credit System and commercial banks to unload their nonperforming assets, it would permit them to remain a viable and competitive source of agricultural credit.

Disadvantages

- Creating Aggie Mae would inhibit the necessary restructuring of the farm sector by providing subsidized credit. It does not address the oversupply problem because it keeps land in production and may exacerbate it if the rents charged are forced below market due to political pressures.
- Creating Aggie Mae would establish a precedent for other troubled lenders, such as thrift institutions, to seek a similar dumping ground for problem loans.
- Creating Aggie Mae could result in a permanent Federally-chartered entity to manage and rent real estate and farm equipment.

Attachment

APPENDIX

Commercial Banks. At the end of 1984, about 5.1 percent, or $2 billion, of all commercial bank farm production loans were nonperforming, compared with 3.9 percent a year earlier. However, a significant proportion of nonperforming loans are held by money center banks. The number of rural agricultural bank failures has increased substantially during the current year, and the Federal Deposit Insurance Corporation (FDIC) expects over 50 agricultural banks to fail by year end -- just over half of all expected bank failures. With declines in land values continuing, many operating and real estate loans are becoming undercollateralized. Because most of the banks failing are very small, they have little impact on the banking system.

Cooperative Farm Credit System (FCS). The FCS was originally created as a government-sponsored enterprise. The FCS is able to borrow at about 5-20 basis points above Treasury securities because the market believes its securities are backed by the Federal Government, even though there is no explicit guarantee.

The overall condition of the FCS is basically sound. Of the $13 billion in stock, retained earnings, and loss allowances, the FCS has $4 billion to $6 billion in relatively liquid assets and also holds about $500 million to $1 billion of short-term lines of credit.

Notwithstanding the overall sound condition of the FCS, several elements of the system are facing severe financial difficulties. Several problem districts, particularly the Omaha district (including Nebraska, South Dakota, Iowa, and Wyoming), may require a total of about $1.8 billion within 60-90 days to stabilize their competitive position.

The fundamental problems faced by the FCS are twofold. First, the system is highly decentralized and operates on a consensus management basis. Because the FCS's equity is spread among about 900 separate entities and these entities are required to share losses only if there is a technical default, districts requiring additional equity in order to stabilize operations cannot easily draw on the reserves of other districts. Second, the Farm Credit Administration, which oversees the FCS, lacks regulatory authority and the necessary enforcement powers to require acceptable credit standards.